



# Sales and Use Taxes

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# Sales and Use Taxes

## Revenues

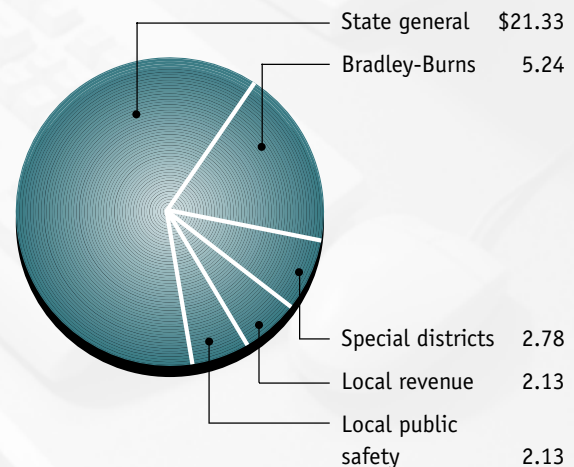
In 1999-00, total California sales and use tax revenue reached \$33.6 billion, an increase of 12 percent from the previous year's total of \$30.0 billion. 1999-00 revenues included:

- \$25.6 billion from the 6 percent state sales tax, with
  - \$21.3 billion — 5 percent — allocated to the state General Fund,
  - \$2.13 billion — 0.5 percent — allocated to the state's Local Revenue Fund, and
  - \$2.13 billion — 0.5 percent — allocated to the Local Public Safety Fund.
- \$5.24 billion from the 1.25 percent Bradley-Burns Uniform Local Sales and Use Tax, allocated among all of the state's 58 counties and 474 cities.
- \$2.78 billion in special district transactions (sales) and use tax (rates vary by district).

1999-00 revenues allocated to the state General Fund, \$21.3 billion, were 11.5 percent higher than revenues for 1998-99.

### 1999-00 Sales and Use Tax Revenues

*Billions of Dollars*



## Programs

California's sales tax, paid by retailers engaged in business in the state, applies to all retail sales of tangible personal property except those specifically exempted by law. The use tax generally applies to the storage, use, or other consumption in this state of goods purchased from retailers in transactions not subject to the sales tax. Use tax also may apply to purchases shipped to a California consumer from another state, including purchases made by mail order, phone, or over the Internet.

The statewide rate for both the sales and use tax, unchanged since 1991, was 7.25 percent in fiscal year 1999-00 (combined 6 percent state rate and 1.25 percent local rate). The total sales and use tax rate is higher in areas where special transactions and use taxes are in effect.

As detailed on the previous page, sales and use taxes provide revenue to the state's General Fund, to local governments through specific state fund allocations, and to local jurisdictions.

### Local Sales and Use Tax

The Board of Equalization collects the 1.25 percent Bradley-Burns Uniform Local Sales and Use Tax and allocates resulting revenue among all California cities and counties. For each sale, one-quarter percent of the 1.25 percent local tax is allocated to the county where the sale occurs and is used to fund transportation projects. The remaining one percent of the tax is allocated to the county or an incorporated city, generally depending on the location of the sale.

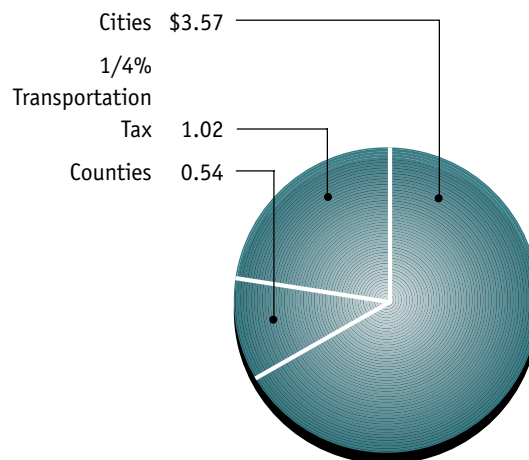
City and county local tax distributions are detailed in Table 21A of the Appendix, beginning on page A-26.

**Redevelopment Agencies.** Between 1981 and 1994, cities were authorized to finance

redevelopment projects with revenue derived from the local sales and use tax and distributed under agreement to city redevelopment agencies. While this authority was repealed effective January 1, 1994, existing city ordinances were permitted to continue. Thirty-seven redevelopment projects in 26 California cities and counties were receiving sales and use tax revenue as of June 30, 2000.

### 1999-00 Local Sales and Use Tax Distributions

*Billions of Dollars*



### District Transactions (Sales) and Use Tax

The Board of Equalization collects and distributes district transactions (sales) and use tax on behalf of voter-approved special tax districts established throughout the state. Revenues fund transportation projects, open space protection, hospitals, county services, public libraries, and schools.

At the beginning of the 1999-00 fiscal year, there were 34 special tax districts in the state, with rates ranging from 0.125 percent to 0.50 percent. On April 1, 2000, the new 0.30 percent City of Clovis Public Safety Transactions and Use Tax went into

effect. The tax is applicable only within the city limits of Clovis.

Sales made by retailers engaged in business in a special tax district are subject to a total sales tax rate that includes the statewide rate of 7.25 percent and the applicable district tax rate. While the provisions of the Transactions and Use Tax Law are similar to state and local sales and use tax laws, significant differences do exist, including an exemption for sales shipped to a location outside the district for use in that location. There are also special requirements for sales of registered vehicles, aircraft, and undocumented vessels.

## Operations

The Board encourages voluntary tax law compliance, offering sales and use tax assistance through its Sacramento headquarters and 26 field offices located across the state. Staff in Board offices in New York, Chicago, and Houston assist taxpayers who are located outside California but registered to do business in this state.

The number of registered sellers decreased slightly this fiscal year, totaling 974,904 as of June 30, 2000. The agency processed more than three million sales and use tax returns in 1999-00.

## Compliance Activities

Board compliance staff ensure that sellers properly comply with permit requirements, assist taxpayers in interpreting tax laws and regulations, and provide classroom instruction and individual assistance in the correct preparation of tax returns. In 1999-00, compliance staff collected more than \$604 million in delinquent sales and use taxes.

This year, the Board streamlined its installment payment agreement process, making it easier for taxpayers to pay their tax debts to the state. The

Sales and Use Tax Department also launched a pilot program to determine the costs and benefits of centralizing the collection of a portion of the accounts receivable previously assigned to field offices.

## Consumer Use Tax Section

Working closely with state and federal agencies, the Consumer Use Tax Section administers the use tax due on nondealer sales of vehicles, vessels, aircraft, and mobile homes and on purchases identified on customs declarations. Fiscal year 1999-00 revenues of \$564.4 million included

- \$494 million collected by the Department of Motor Vehicles; and
- \$11.7 million collected by the Department of Housing and Community Development.

Consumer use tax collections this year increased by 11.7 percent over collections in 1998-99.

## Audit Program

The Board maintains an effective audit program to ensure that businesses report neither more nor less tax than prescribed by law. The program audits approximately three percent of active accounts each year, concentrating on those considered most likely to be inaccurate in their tax reporting. In fiscal year 1999-00, the sales and use tax audit program disclosed net deficiencies of nearly \$403.4 million. Taxpayers received more than \$65.4 million in sales and use tax refunds.

## Areas of Taxpayer Noncompliance

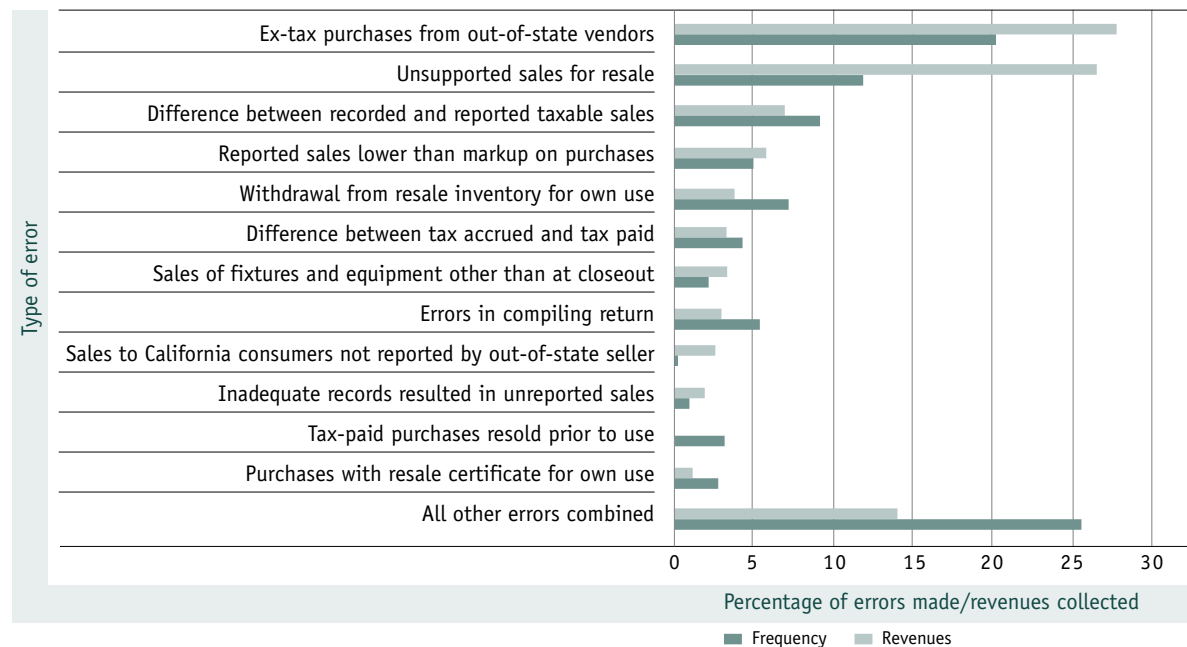
To comply with requirements of the Taxpayers' Bill of Rights, each year the Board

- Identifies the areas of the Sales and Use Tax Law where taxpayer noncompliance is highest; and
- Classifies the types of businesses making errors.

## Analysis of Noncompliance, 1999-00

### Types of Noncompliance

*Frequency of Errors/Revenues Collected*



### Types of Business Making Error

*Ranked by Revenues Collected*

Type of Business	Percentage	Rank for 1998-99
Publishers and Distributors of Light Industrial Equipment	15.90	1
Manufacturers and Wholesalers of Electronic Equipment	7.88	2
Business Services Concerns	7.01	4
Construction Contractors and Sellers of Building Materials	5.56	3
Manufacturers and Wholesalers of Store and Office Equipment	5.54	6
Manufacturers and Wholesalers of Drugs and Chemicals	4.76	24
Full-time Specialty Stores	4.42	19
Office Stores and School Furniture Equipment Stores	4.31	13
Producers and Distributors of Heavy Industrial Equipment	4.30	7
Repair and Hand Trade Shops	3.58	8
All Other Businesses	36.76	
Total	100.00	



Failure to pay use tax on purchases from out-of-state vendors was identified as the most frequent category of taxpayer noncompliance this fiscal year, and the most costly. Nearly 28 percent of net sales and use tax audit deficiencies occurred in that category — totaling almost \$75 million of unpaid tax. Making sales for resale without supporting documentation was the second-most-common and costly error. This noncompliance category accounted for more than 26.7 percent of all net sales and use tax audit deficiencies, or more than \$71.7 million in unpaid tax.

The charts on the previous page summarize the Board's findings on the types of taxpayer noncompliance for fiscal year 1999-00 and provide other tax compliance information required by the Taxpayers' Bill of Rights.

## Appeals

Taxpayers who disagree with Board audit results or other decisions regarding the application of sales and use tax may seek resolution through the Board's administrative appeals process. For information on appeals filed in 1999-00, see chapter 6, "Appeals," which begins on page 47.

The agency also offers a settlement program as an alternative method of tax dispute resolution.

In 1999-00, the Board approved 300 sales and use tax cases for settlement. The total settlement amount was \$27.09 million. Settlement case processing time was reduced to nine months or less this fiscal year.

## Court Decisions

### Prerequisite for Refund Claim or Court Action

The Supreme Court held that payment of accrued interest on a tax deficiency is not required as a prerequisite to an administrative refund claim or a court action for refund of tax. The court also criticized the recent case of *Garg v. People ex rel. State Bd. Of Equalization* (1997) 53 Cal.App.4<sup>th</sup> 199, which had earlier concluded that payment of interest was required.

*Agnew v. State Board of Equalization* (1999)  
21 Cal.4<sup>th</sup> 310

### Motor Vehicle Smog Impact Fee

The Board was included as a defendant with DMV and the State of California in a challenge to the motor vehicle smog impact fee, which was imposed upon the registration of motor vehicles previously registered outside of California. The court of appeal held that the motor vehicle smog impact fee violates the commerce clause of the United States Constitution. The court of appeal also held that, because the motor vehicle smog impact fee was not a sales or use tax, placing the revenues from the fee into the General Fund violated article XIX of the California Constitution. However, the appeal court found that the trial court's remedy ordering the state to file claims on behalf of taxpayers paying the smog impact fee exceeded that court's jurisdiction. (See related refund legislation on page 32.)

*Jordan, et al., v. California Department of Motor Vehicles et al.* (1999) 75 Cal.App.4<sup>th</sup> 449

## Legislation

### Expanded Taxpayers' Bill of Rights

In part, this Board-sponsored bill

- Suspends the statutes of limitations for filing claims for refund while a person is financially disabled by a medical or mental impairment, as defined.
- Requires the Board on or before July 1, 2000, to provide an annual statement to each taxpayer who has an installment payment agreement with the Board, setting forth the balance at the beginning of the year, the payments made during the year, and the remaining balance at the end of the year.

*Assembly Bill 1638, Chapter 929, Statutes of 1999; operative January 1, 2000*

### Publication of Top 12 Tax Delinquencies

Requires the Board to make available to the public a quarterly list of the top 12 delinquent taxpayers who owe at least \$1 million in tax and to provide 30-day advance written notice to candidates for the list. Provides that taxpayers who pay the tax they owe or make payment arrangements within the 30-day period shall not be listed.

*Assembly Bill 790, Chapter 443, Statutes of 1999; operative January 1, 2000*

### Simplified Prepayment Reporting

This Board-sponsored measure changes the prepayment due dates so that all prepayments are due on the 24<sup>th</sup> of the month and includes other provisions to simplify sales tax prepayment reporting.

*Assembly Bill 384, Chapter 484, Statutes of 1999; operative January 1, 2000*

### Art Transferred at Social Gatherings

Exempts from sales and use tax the transfer of original drawings, sketches, illustrations, and paintings when they are transferred by an artist or designer for entertainment purposes at a social gathering, provided certain conditions are met.

*Senate Bill 330, Chapter 799, Statutes of 1999; operative April 1, 2000*

### Pet Adoptions and Related Services

Exempts from sales and use tax the transfer of any animal for use as a pet when the transfer is made by a local government animal shelter or qualifying nonprofit animal welfare organization, as defined. Exempts from sales and use tax any charges by the government shelter or organization related to the transfer of the animal, including spaying or neutering, future spaying or neutering, vaccination, future vaccination, or similar service.

*Assembly Bill 563, Chapter 361, Statutes of 1999; operative January 1, 2000*

### Oxygen for Food Animals

Exempts from tax the sale and use of oxygen administered to food animals primarily to prevent or control disease.

*Senate Bill 963, Chapter 289, Statutes of 1999; operative January 1, 2000*

### Returnable Food Containers

Exempts from tax the sale or use of any empty container transferred to a person who places human food products in it for shipment, provided the food products will be sold.

*Senate Bill 1210, Chapter 758, Statutes of 1999; operative April 1, 2000*



### Sales Tax Omnibus Measure

Among its provision, this bill

- Authorizes the Board to accept electronically filed sales and use tax returns.
- Limits to 6 percent the total penalty applied when an Electronic Funds Transfer (EFT) taxpayer does not file a prepayment on time and fails to pay by EFT.
- Authorizes the Board to compute the sales tax prepayment rate for jet and diesel fuel independently from the sales tax prepayment rate for gasoline.
- Allows qualified motor vehicle fuel distributors to seek a refund of tax reimbursement paid to a distributor who is not qualified to obtain tax-exempt motor vehicle fuel.

*Senate Bill 1302, Chapter 865, Statutes of 1999; effective January 1, 2000*

### Local Jurisdictions — Seller's Permit Information

Authorizes cities and counties to collect seller's permit application information from retailers who wish to do business in their jurisdictions. Requires the Board to process the resulting application information and report back to the submitting jurisdiction, to consult with specified local government organizations regarding establishment of certain permit conventions, and to make related reports to the Legislature.

*Assembly Bill 990, Chapter 908, Statutes of 1999; operative January 1, 2000, through January 1, 2004*

### Transactions and Use Tax — Yucca Valley

Authorizes the Town of Yucca Valley, upon voter approval, to levy a transactions and use tax to fund transportation projects and parks.

*Assembly Bill 1371, Chapter 110, Statutes of 1999; operative January 1, 2000*

### Refunds of Vehicle Smog Impact Fee

Requires the Department of Motor Vehicles (DMV) to identify all persons who paid the \$300 smog impact fee since October 1, 1990, mail a refund notification form to those persons, and provide a refund of \$300 plus any penalty fee collected, with interest, to each person who returns the form to the DMV, as specified. Appropriates \$665 million from the state's General Fund to the Smog Impact Fee Refund Account for purposes of funding the refunds. (Note: the Vehicle Smog Impact Fee was declared unconstitutional on October 1, 1999. See page 30.)

*Assembly Bill 809, Chapter 31, and Senate Bill 215, Chapter 32, Statutes of 2000; operative June 8, 2000.*

## Regulations

### Sales and Use Tax

#### Computers, Programs, and Data Processing

Regulation 1502, *Computers, Programs, and Data Processing*, was amended to clarify that within the printing industry, the digital instructions that result from "electronic or digital prepress instruction," as defined, are considered a custom computer program when prepared to the order of a customer. The regulation further specifies that the transfer of such custom instructions on digital storage media is not taxable.

*Title 18, California Code of Regulations, section 1502; effective December 3, 1999*

#### Construction Contractors

Regulation 1521, *Construction Contractors*, was amended to provide that tax applies to 33 percent of a contract's lump-sum charge for furnishing and installing an "on-premises electric sign," as defined.

*Title 18, California Code of Regulations, section 1521; effective May 18, 2000*



### **Teleproduction or Other Postproduction Service Equipment**

Regulation 1532, *Teleproduction or Other Postproduction Service Equipment*, was adopted to interpret and apply Revenue and Taxation Code section 6378, which provides a partial state sales and use tax exemption for the purchase of tangible personal property by a qualified person who will use it in California primarily for teleproduction or other postproduction services.

*Title 18, California Code of Regulations, section 1532; effective January 8, 2000*

### **Advertising Agencies, Commercial Artists, and Designers**

Regulation 1540, *Advertising Agencies, Commercial Artists and Designers*, was amended to generally treat advertising agencies as agents of their clients; to clarify when transfers of images on electronic media are nontaxable; to rebuttably presume that 75 percent of an advertising agency's or commercial artist's lump-sum charge for artwork is generally for nontaxable services; and to clarify that tax applies to the transfer of reproduction rights for artwork, but only for one year after the original transfer of the artwork in tangible form.

*Title 18, California Code of Regulations, section 1540; effective April 23, 2000*

### **Printing and Related Arts**

Regulation 1541, *Printing and Related Arts*, was amended to update definitions and explanations of printing technology and practices and to make a number of clarifications. The regulation clarifies when the special instructions that result from "electronic or digital prepress instruction," as defined, are considered a custom computer program, and specifies that the transfer of such custom instructions on digital storage media is not taxable. Other clarifications include describing

how tax applies to the sale and use of special printing aids, distinguishing between repair and fabrication labor for film alteration done by color separators, and explaining how tax applies when artwork is included as part of composed type.

*Title 18, California Code of Regulations, section 1541; effective December 3, 1999*

### **Modular Systems Furniture**

Regulation 1583, *Modular Systems Furniture*, was adopted to explain how tax applies to the sale and installation of modular systems furniture.

*Title 18, California Code of Regulations, section 1583; effective December 3, 1999*

### **Animal Life, Feed, Drugs and Medicines**

Regulation 1587, *Animal Life, Feed, Drugs and Medicines*, was first amended to clarify that tax does not apply to the sale or use of cellulose casings used in the manufacture and production of processed meat products when the casings are ultimately resold as, or incorporated into, feed for food animals, or for non-food animals held for sale.

*Title 18, California Code of Regulations, section 1587; effective October 1, 1999*

This amendment incorporated the provisions of Revenue and Taxation Code section 6358, which exempts from tax the sale and use of oxygen administered to food animals primarily to prevent or control disease. Another amended subsection provides that the term "food animals" includes any form of animal life classified as livestock or poultry intended for human consumption in regulations adopted by the California Department of Food and Agriculture under sections 18848 and 25408 of the California Food and Agricultural Code.

*Title 18, California Code of Regulations, section 1587; effective May 18, 2000*

### Containers and Labels

Regulation 1589, *Containers and Labels*, was amended to clarify specific instances when a container is deemed “not customarily returned by the buyer” and to clarify how tax applies to leases of returnable containers.

*Title 18, California Code of Regulations, section 1589; effective October 15, 1999*

### Medicines and Medical Devices

Regulation 1591, *Medicines and Medical Devices*, was amended to reorganize the regulation into five separate regulations, to incorporate definitions from the Business and Professions Code and previous legal interpretations, and to provide that insulin blood-monitoring equipment and glucose test strips qualify as medicines. Certain subdivisions were deleted from Regulation 1591 and the subject matter of the deletions expanded and incorporated into new Regulation 1591.1, *Specific Medical Devices, Appliances, and Related Supplies*; Regulation 1591.2, *Wheelchairs, Crutches, Canes, and Walkers*; Regulation 1591.3, *Vehicles for Physically Handicapped Persons*; and Regulation 1591.4, *Medical Oxygen Delivery Systems*.

*Title 18, California Code of Regulations, sections 1591, 1591.1, 1591.2, 1591.3, and 1591.4; effective March 10, 2000*

### Interstate and Foreign Commerce

Regulation 1620, *Interstate and Foreign Commerce*, was amended to establish guidelines for determining when California use tax applies to purchases of vehicles (generally trucks and buses) for use in interstate or foreign commerce.

*Title 18, California Code of Regulations, section 1620; effective February 23, 2000*

### Packers, Loaders, and Shippers

Regulation 1630, *Packers, Loaders, and Shippers*, was amended to clarify that products such as wax and fungicide, post-harvest protective shields, and protective coatings can be purchased for resale when they will be physically incorporated into products being sold. The regulation was also amended to explain when tax does not apply to the sale or purchase of preservative products.

*Title 18, California Code of Regulations, section 1630; effective October 27, 1999*

### Leases of Tangible Personal Property

Regulation 1660, *Leases of Tangible Personal Property – In General*, was amended to clarify that when the lessor is a bank or financial corporation, use tax does not apply to personal property taxes included in taxable rental payments.

*Title 18, California Code of Regulations, section 1660; effective May 25, 2000*

### Leases of Mobile Transportation Equipment

Regulation 1661, *Leases of Mobile Transportation Equipment*, was amended to clarify that when the lessor is a bank or financial corporation, the fair rental value of mobile transportation equipment does not include personal property taxes, under certain conditions.

*Title 18, California Code of Regulations, section 1661; effective May 27, 2000*

### Demonstration, Display, and Use of Property Held for Resale

Regulation 1669, *Demonstration, Display and Use of Property Held for Resale – General*, was amended to clarify that when a bank or financial corporation is the lessor of mobile transportation equipment held

for resale, personal property taxes are not included in the fair rental value of that equipment.

*Title 18, California Code of Regulations, section 1669; effective May 24, 2000*

### **Collection of Use Tax by Retailers**

Regulation 1684, *Collection of Use Tax by Retailers*, was amended to reflect an amendment to Revenue and Taxation Code section 6203 regarding trade show and convention activities by out-of-state retailers, and to reflect the adoption of Revenue and Taxation Code section 7051.3 concerning use tax direct-payment exemption certificates.

*Title 18, California Code of Regulations, section 1684; effective October 5, 1999*

### **Payment of Tax by Purchasers**

Regulation 1685, *Payment of Tax by Purchasers*, was amended to reflect Revenue and Taxation Code section 7051.3, which concerns use tax direct-payment exemption certificates.

*Title 18, California Code of Regulations, section 1685; effective October 21, 1999*

### **Successor's Liability**

Regulation 1702, *Successor's Liability*, was amended to clarify the circumstances under which a person who has purchased a business will be relieved of a penalty owed by the previous business owner.

*Title 18, California Code of Regulations, section 1702; effective October 27, 1999*

### **Interest and Penalties**

Regulation 1703, *Interest and Penalties*, was amended to clarify and explain when the Board will not pay interest on refunds of overpayments.

*Title 18, California Code of Regulations, section 1703; effective January 8, 2000*

### **Relief from Liability**

Regulation 1705, *Relief from Liability*, was amended to clarify when an annotation or a legal ruling of counsel constitutes written advice covered by the provisions of Revenue and Taxation Code section 6596.

*Title 18, California Code of Regulations, section 1705; effective January 7, 2000*

### **Uniform Local Sales and Use Tax**

#### **Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes**

Regulation 1802, *Place of Sale and Use for Purposes of Bradley-Burns Uniform Local Sales and Use Taxes*, was amended to define the place of jet fuel sale by incorporating Revenue and Taxation Code section 7204.03 and amendments to Revenue and Taxation Code section 7205.

*Title 18, California Code of Regulations, section 1802; effective May 26, 2000*

### **Transactions and Use Tax**

#### **Collection of Use Tax by Retailers**

Regulation 1827, *Collection of Use Tax by Retailers*, was amended to reflect the adoption of Revenue and Taxation Code section 7051.3, which concerns use tax direct-payment exemption certificates.

*Title 18, California Code of Regulations, section 1827; effective October 22, 1999*